

## TEST YOURSELF ON FINANCIAL ASSETS

### True or False

For each of the following statements, circle the T or the F to indicate whether the statement is true or false.

- |   |   |    |   |
|---|---|----|---|
| T | F | 1. | The term "financial asset" has the same meaning as the term "cash equivalents."   |
| T | F | 2. | The balance sheet item of Cash and Cash Equivalents includes amounts on deposit with banks and also currency, money orders, and customers' checks on hand.  |
| T | F | 3. | For strong internal control, the employee who opens incoming mail should not also be responsible for preparing a control listing of checks received in the mail.  |
| T | F | 4. | Internal control over cash should include measures to prevent fraud or loss, to provide accurate records of cash transactions, and to ensure the maintenance of adequate but not excessive cash balances. |
| T | F | 5. | For strong internal control, an employee who handles cash receipts should not be responsible for issuing credit memoranda for sales returns.  |

- T F 6. Internal control over cash receipts is most effective when one person is made solely responsible for receiving and depositing cash and making related entries in the accounting records.
- T F 7. All cash receipts should be deposited intact in the bank daily, and all material cash payments should be made by check.
- T F 8. No entry is made in the accounting records at the time a small payment is made from the petty cash.
- T F 9. The Petty Cash account should be debited at the time it is replenished.
- T F 10. Reconciling a bank account means determining that all deductions shown on the bank statement represent checks issued by the depositor in the current period.
- T F 11. The purpose of preparing a bank reconciliation is to identify those items which cause the balance of cash per the bank statement to differ from the balance of cash per the ledger, and thereby to determine the correct cash balance.
- T F 12. In preparing a bank reconciliation, outstanding checks should be deducted from the balance shown on the bank statement, and deposits in transit (or undeposited receipts) should be added to the bank balance.
- T F 13. After preparing a bank reconciliation, journal entries should be made to record each of the items shown as adjustments to the balance per depositor's records.
- T F 14. James Company deposited a check from a customer, Ray Prince, but the bank returned the check with the notation NSF and deducted it on James Company's bank statement. A telephone call to Prince's office indicated that he would be out of town for some weeks. James Company decided to hold the check until Prince returned. The check should be included in the figure for Cash on the balance sheet of James Company.
- T F 15. Short-term investments in marketable securities are reported in the balance sheet at **cost**, but their **current market value** must be disclosed in footnotes to the financial statements.
- T F 16. When an investment in marketable securities is **sold**, gain or loss is computed by comparing sales price with the current market value of the investment reported in the most recent balance sheet.
- T F 17. The balance of the Unrealized Holding Gain (or Loss) account represents the difference between the cost of securities owned and their current market values as of the balance sheet date.

- T F 18. The mark-to-market adjustment for the current period is the same dollar amount as the balance of the Unrealized Holding Gain (or Loss) on Investments in Marketable Securities account.
- T F 19. The practice of estimating uncollectible accounts expense at the end of each accounting period is designed to match revenue and expenses so that all expenses associated with the revenue earned in the period are recognized as expense in that same period.
- T F 20. During the first year of its existence, Cross Company made most of its sales on credit but made no provision for uncollectible accounts. The result would be an overstatement of assets and owners' equity, an understatement of expense, and an overstatement of net income.
- T F 21. Conservatism in the valuation of accounts receivable would call for holding the amount entered in Allowance for Doubtful Accounts to a bare minimum.
- T F 22. The **balance sheet** approach to estimating uncollectible accounts expense emphasizes the aging of accounts receivable and the adjustment of the allowance account to the level of the estimated uncollectible amount.
- T F 23. The **income statement** approach to estimating uncollectible accounts expense does not require the use of an allowance account.
- T F 24. When the year-end provision for uncollectible accounts expense is estimated as a percentage of sales, the estimate is recorded without regard for the existing balance in the allowance account.
- T F 25. The **direct write-off** method does not cause receivables to be stated in the balance sheet at their estimated realizable value.
- T F 26. When a given account receivable is determined to be worthless, it should be written off the books by an entry debiting Uncollectible Accounts Expense and crediting the Allowance for Doubtful Accounts.
- T F 27. When a company collects an account receivable previously written off as worthless, an entry should be made debiting Accounts Receivable and crediting Allowance for Doubtful Accounts. A separate entry is then made to record collection of the account.
- T F 28. The write-off of an account receivable determined to be worthless by debiting the Allowance for Doubtful Accounts will not affect the net carrying value of the receivables in the balance sheet.
- T F 29. **Factoring accounts receivable** refers to the process of categorizing accounts receivable according to age.

- T F 30. A retailer who sells to a customer using a national credit card will have an uncollectible account if the customer never pays the credit card company.
- T F 31. When a retail store sells merchandise to a customer who uses a bank card (such as Visa or MasterCard), the account to be debited is Cash rather than Accounts Receivable.
- T F 32. When a company accepts an interest-bearing note from a customer, the interest charges should be recognized as revenue at the time the note is received.
- T F 33. Effective management of accounts receivable include efforts to maximize this asset and to reduce accounts receivable turnover rate.
- T F 34. A company with an accounts receivable turnover rate of 12 requires, on average, less than two weeks to collect its accounts receivable.

### Completion Statements

Fill in the necessary word to complete the following statements:

1. The term **financial assets** includes \_\_\_\_\_, short-term investments (such as \_\_\_\_\_ and \_\_\_\_\_), and \_\_\_\_\_.
2. The term **cash** includes not only currency, coin, and money orders, but also \_\_\_\_\_ and the balances of \_\_\_\_\_.
3. An adequate system of internal control over cash should include separating the function of handling cash from the \_\_\_\_\_.
4. Cash frauds often begin with temporary unauthorized "borrowing" by employees of cash received from customers. One effective step in preventing such irregularities is to insist that each day's cash receipts be \_\_\_\_\_ in the bank.
5. Among the most common reconciling items in a bank reconciliation are \_\_\_\_\_, which should be deducted from the balance shown by the banks, and \_\_\_\_\_, which should be added to the balance shown by the bank statement.
6. The abbreviation **NSF** applied to a check return by a bank means \_\_\_\_\_, and calls for an entry on the depositor's book debiting \_\_\_\_\_.

7. In the preparation of a bank reconciliation, various reconciling items are added to or deducted from the balance per the bank statement or the balance per the depositor's records. Outstanding checks should be \_\_\_\_\_ the balance per the \_\_\_\_\_. Deposits in transit to the bank should be \_\_\_\_\_ the balance per the \_\_\_\_\_. Collections made by the bank on behalf of the depositor should be \_\_\_\_\_ the balance per the \_\_\_\_\_.
8. Short-term investments in marketable securities are reported in the balance sheet at \_\_\_\_\_; the valuation principle applicable to marketable securities is termed \_\_\_\_\_.
9. When an investment in marketable securities is sold, the gain or loss recognized in the income statement is determined by comparing \_\_\_\_\_ with \_\_\_\_\_. The required balance in the Unrealized Holding Gain (or Loss) is determined by comparing \_\_\_\_\_ with \_\_\_\_\_ of securities owned at the balance sheet date.
10. The accounting principle which underlies the practice of estimating uncollectible accounts expense each period is known as the \_\_\_\_\_. This process is essential to the periodic determination of \_\_\_\_\_.
11. If the Allowance for Doubtful Accounts is understated, the net realizable value of accounts receivable will be \_\_\_\_\_, equity will be \_\_\_\_\_, and net income will be \_\_\_\_\_.
12. The income statement approach to uncollectible accounts emphasizes estimating the \_\_\_\_\_ for the period, while the balance sheet approach emphasizes estimating the proper level for the \_\_\_\_\_.
13. The Inn Place made credit sales of \$4,200 to customers using Global Express credit cards. Global Express charges retailers a fee of 4%. The entry to record collecting the cash from these credit sales would be a debit to Cash for \$ \_\_\_\_\_, a \_\_\_\_\_ to \_\_\_\_\_ for \$ \_\_\_\_\_, and a \_\_\_\_\_ to \_\_\_\_\_ for \$ \_\_\_\_\_.
14. If the interest on a 60-day note with a face value of \$10,000 amounts to \$250, the rate of interest is \_\_\_\_\_% (express as an annual rate.)
15. The entry to record interest accrued on notes receivable at year-end consists of a debit to \_\_\_\_\_ and a credit to \_\_\_\_\_. Of these accounts, the one to be closed into the Income Summary is \_\_\_\_\_.

## Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided.

1. Which of the following is **not** accurate with respect to financial assets?
  - a. Financial assets include accounts receivable and notes receivable, as well as short-term investments in the stock of publicly traded corporations.
  - b. Financial assets are reported in the financial statements at values determined in accordance with the cost principle.
  - c. Financial assets are reported in the balance at the amounts of cash these assets represent.
  - d. All financial assets are current assets, but not all current assets are financial assets.
2. Which of the following practices is undesirable from the standpoint of maintaining adequate internal control over cash?
  - a. Appointing as custodian of a petty cash fund an employee who has no responsibility with respect to maintenance of accounting records.
  - b. Recording overages and shortages from errors in handling over-the-counter cash receipts in a ledger account, Cash Over and Short.
  - c. Authorizing the cashier to make bank deposits.
  - d. Authorizing the official who approves invoices for payment to sign checks.
3. Checks received through the mail should be:
  - a. Transmitted to the accounts receivable department without delay.
  - b. Deposited by the mail-room employee.
  - c. Listed by the mail-room employee and forwarded to the cashier; a copy of the list should be sent to the accounting department.
  - d. Handled first by the accounting department, which, after making appropriate entries in the accounts, should turn over the checks to the cashier to be made a part of the daily bank deposit.
4. Which of the following is **not** a significant element of internal control over cash disbursements?
  - a. Perforating or stamping "Paid" on supporting invoices and vouchers.
  - b. Using serially numbered checks and accounting for all numbers in the series.
  - c. Use of a Cash Over and Short account.
  - d. Establishment of a petty cash fund.
5. Which of the following is **not** a significant element of internal control over cash receipts?
  - a. Preparing a control listing of checks received in the mail.
  - b. Establishing a petty cash fund.
  - c. Depositing each day's cash receipts intact in the bank.
  - d. Prenumbering sales tickets.

- 6. In establishing and maintaining a petty cash fund:
- a. The Petty Cash account is debited only when the fund is first established or subsequently changed in size.
  - b. The Petty Cash account is debited whenever the fund is replenished.
  - c. The contents of the fund should at all times be limited to currency, coin, and checks.
  - d. The contents of the fund should at all times be limited to currency, coins, checks, money orders, undeposited cash receipts, petty cash vouchers, and notes receivables from employees.
- 7. An NSF check held by the payee should be carried on its records as:
- a. An element of cash on hand.
  - b. Notes receivable.
  - c. Accounts receivable.
  - d. Cash over and short.
- 8. When a bank reconciliation has been satisfactorily completed, the only related entries to be made on the depositor's books are:
- a. To record items which explain the difference between the balance per the books and the adjusted cash balance.
  - b. To record items which explain the difference between the balance per the books and the balance per the bank statement.
  - c. To correct errors existing in the bank statement.
  - d. To record outstanding checks and deposit in transit.
- 9. Before a bank reconciliation was prepared, the accounting records of Adams Company showed a cash balance of \$26,440 and the bank statement showed a balance of \$32,500. The bank statement showed a balance of \$32,500. The reconciling items are a deposit in transit of \$2,620; outstanding checks of \$8,700; and bank service charges of \$20. Based upon these facts, the amount of cash that should be shown on Adam's balance sheet is:
- a. \$35,120.
  - b. \$26,420.
  - c. \$20,360.
  - d. Some other amount.
- 10. The *mark-to-market* concept:
- a. Is the valuation applied to all financial assets.
  - b. Involves recognition of a current period gain or loss, as well as the adjustment of an asset account.
  - c. Requires footnote disclosure of the current market values of marketable securities.
  - d. Has no effect upon the net income of the period.

11. Scott Corporation sold marketable securities costing \$500,000 for \$516,000 cash. This transaction is reported in Scott's income statement and statement of cash flows, respectively, as:
- a. A \$516,000 gain and a \$516,000 cash receipt.
  - b. A \$16,000 gain and a \$516,000 cash receipt.
  - c. A \$16,000 gain and a \$16,000 cash receipt.
  - d. No effect on the income statement; a \$516,000 cash receipt in the statement of cash flows.
12. Fisher Corporation invested \$400,000 cash in marketable securities early in December. The entire investment was classified as available for sale securities. On December 31, the quoted market price for these securities is \$419,000. Which of the following is an accurate statement?
- a. If Fisher sells these investments on January 2 for \$410,000, it will report a loss of \$9,000 in the January income statement.
  - b. Fisher's December 31 balance sheet reports and marketable securities at \$400,000 and an Unrealized Holding Gain on Investments of \$19,000.
  - c. Fisher's December 31 balance sheet reports and marketable securities at \$419,000 and an Unrealized Holding Gain on Investments of \$19,000.
  - d. Fisher's December income statement includes a \$19,000 gain on investments.
13. When an allowance for estimating uncollectible accounts is in use, the writing off of an individual account receivable as worthless will:
- a. Be recorded by a debit to Uncollectible accounts Expense.
  - b. Increase the balance in the allowance account.
  - c. Decrease the debit balance in the allowance account.
  - d. Have no effect on the working capital of the company.
14. Bryan Company, after aging its accounts receivable, estimated that \$3,500 of the \$125,000 of receivables on hand would probably prove uncollectible. The Allowance for Doubtful Accounts contained a credit balance of \$2,300 prior to adjustments. The appropriate accounting entry is:
- a. A debit to Uncollectible Accounts Expense and a credit to Allowance for Doubtful Accounts for \$1,200.
  - b. A debit to Uncollectible Accounts Expense and a credit to Allowance for Doubtful Accounts for \$3,500.
  - c. A debit to Uncollectible Accounts expense and a credit to Allowance for Doubtful Accounts for \$5,800.
  - d. A debit to Allowance for Doubtful Accounts and a credit to Accounts Receivable for \$3,500.



- \_\_\_ 15. Pine Company uses the income statement approach in estimating uncollectible accounts expense and has found that such expense has consistently approximated 1% of net sales. At December 31 of the current year receivables total \$150,000 and the Allowance for Doubtful Accounts has a credit balance of \$400 prior to adjustment. Net sales for the current year were \$600,000. The adjusting entry should be:
- a. A debit to Uncollectible Accounts Expense and a credit to Allowance for Doubtful Accounts for \$5,600.
  - b. A debit to Uncollectible Accounts Expense and a credit to Allowance for Doubtful Accounts for \$6,400.
  - c. A debit to Allowance for Doubtful Accounts and a credit to Accounts Receivable for \$6,000.
  - d. A debit to Uncollectible Accounts Expense and a credit to Allowance for Doubtful Accounts for \$6,000.
- \_\_\_ 16. Crawford Company uses the direct write-off method in accounting for uncollectible accounts. Crawford recognizes uncollectible accounts expense:
- a. As indicated by aging the accounts receivable at the end of the period.
  - b. As a percentage of net sales during the period.
  - c. As accounts receivable from specific customers are determined to be worthless.
  - d. As a percentage of net credit sales during the period.
- \_\_\_ 17. The entry to record a sale to a customer who uses a bank credit card (such as Visa or MasterCard) includes a debit to:
- a. An account receivable from the customer.
  - b. An account receivable from the bank.
  - c. Cash.
  - d. Notes receivable.
- \_\_\_ 18. Which of the following statements regarding notes receivable is *false*?
- a. The person who signs the note and promises to pay is called the maker of the note.
  - b. When a company lends money, the company's financial statements should report a note receivable and accrued interest revenue.
  - c. The maker of a note receivable records an asset by debiting Note Receivable in his or her accounting records.
  - d. In determining the number of days used in computing interest, the note's date of origin is not included, but the note's maturity date is included.

19. Mann Company accepts numerous notes receivable from its customers. When the maker of a note defaults, Mann Company should:
- Transfer the principal of the note to Accounts Receivable and write off the accrued interest as a loss.
  - Make no accounting entry if the maker of the defaulted note will sign a renewal note on equally favorable terms.
  - Debit Accounts Receivable for the principal of the note plus interest earned, offset by credit to Notes Receivable and Interest Revenue.
  - Record a liability for the maturity value of the note.
20. Hayden Manufacturing's net credit sales for the current year are \$5,400,000 and average accounts receivable amount to \$675,000. Using 365 days to a year, which of the following is accurate?
- Hayden's accounts receivable turnover ratio is 1 to 8.
  - Hayden's accounts receivable were converted into cash 46 times during the current year.
  - Hayden's average days' sales uncollected is 8 days.
  - Hayden's average days' sales uncollected is 46 days.

### Exercises

1. Listed below are eight technical accounting terms emphasized in this chapter.

*Accounts receivable turnover*  
*Direct write-off method*  
*Concentration of credit risk*  
*Financial asset*

*Bank reconciliation*  
*Allowance method*  
*Cash equivalent*  
*Mark-to-Market*

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms.

- A large portion of receivables due from customers vulnerable to the same economic environment.  
 \_\_\_\_\_
- A determination of the items making up the difference between the bank balance and the balance according to the depositor's records.  
 \_\_\_\_\_
- Method of accounting for uncollectible receivables which fails to match revenue and related expenses.  
 \_\_\_\_\_

- d. Balance sheet valuation standard applicable to investments in marketable securities.  
\_\_\_\_\_
  - e. A ratio, computed by dividing average receivables by net sales, that indicates the liquidity of the receivables.  
\_\_\_\_\_
  - f. Contra-asset account representing the portion of receivables estimated to be uncollectible.  
\_\_\_\_\_
  - g. Cash and assets convertible directly into known amounts of cash, such as marketable securities and receivables.  
\_\_\_\_\_
2. You are to fill in the missing portions of the bank reconciliation shown on the next page for Hunter Construction at July 31, 20\_\_, using the following additional information:
- a. Outstanding checks: no. 301, \$2,500; no. 303 \$600; no. 304 \$1,800; no. 306, \$1,282.
  - b. Service charge by bank, \$6.
  - c. Deposit made after banking hours on July 31, \$1,950.
  - d. A \$264 NSF check drawn by our customer Jay Kline was deducted from our account by the bank and returned to us.
  - e. A \$1,800 note receivable left by us with the bank for collection was collected and credited to our account. No interest is involved.
  - f. Our check no. 295, issued in payment of \$688 for office supplies, was written as \$688 but was erroneously recorded in our accounts as \$580.

**HUNTER CONSTRUCTION**  
**Bank Reconciliation**  
**July 31, 20\_\_**

Balance per bank statement, July 31, 20\_\_ ..... \$17,018

Add:

Deduct:

Adjusted balance ..... \$\_\_\_\_\_

Balance per depositor's records, July 31, 20\_\_ ..... \$11,364

Deduct:

Adjusted balance (as above)..... \$\_\_\_\_\_

3. A list of account titles, each preceded by a number, appears below. In the space provided on the following page, indicate the accounts to be debited and credited in properly recording the five transactions described. In some cases more than one account may be debited or credited.

- a. Cash
- b. Notes Receivable
- c. Interest Receivable
- d. Accounts Receivable
- e. Allowance for Doubtful Accounts
- f. Interest Revenue
- g. Uncollectible Accounts Expense
- h. Credit Card Discount Expense
- i. Service Revenue

Transaction	Account(s)	Accounts(s)
	Debited	Credited
a. <b>Example</b> Rendered services, receiving part cash and the balance on account.	a,d	i
b. Wrote off the account of J. Smith as uncollectible.		
c. Collected cash from a national credit card company (not a bank) for credit card sales made this week.		
d. Reinstated the account of J. Smith, written off in b. above, when Smith promised to make payment.		
e. Collected the J. Smith account in full.		
f. Collected a note receivable, plus interest at maturity date. A portion of the interest collected had been accrued as of the end of the preceding month.		

4. The balance sheet of Carsoni, Inc., included the following items at November 30:

Marketable securities.....	\$510,000
Note receivable.....	10,000
Interest receivable .....	200
Accounts receivable .....	100,000
Less: Allowance for doubtful accounts .....	2,400
Unrealized holding gain on investments in marketable securities.....	15,000

In the space provided, on the following page, prepare general journal entries to record the following events occurring in December (explanations not required):

- Dec. 4 An account receivable for \$230 previously written off is unexpectedly collected. (Make two separate entries.)
- Dec. 8 A \$2,275 account receivable is written off as uncollectible.
- Dec. 16 A 10%, 60-day note receivable is received from a customer in settlement of a \$6,000 account receivable due today.
- Dec. 30 Collected in full a 12% 90-day \$10,000 note receivable and interest due today. As of November 30, \$200 interest receivable had been accrued on this note. (Remember to record interest revenue earned in December.)
- Dec. 31 An aging of accounts receivable indicates the need for a balance of \$3,500 in the allowance for doubtful accounts. (Consider the effects of the transactions on December 4 and December 8 before making the month-end adjusting entry.)
- Dec. 31 Prepared an adjusting entry to record accrued interest on the note received on December 16. (Assume a 360-day year in your interest computation.)
- Dec. 31 On December 31, the current market value of Carsoni's marketable securities is \$518,000. This investment had originally cost Carsoni \$495,000 several months ago, and had been classified as available for sale securities.



5. Compute the interest on the following amounts using the assumption of a 360-day year.

- a. \$12,000 at 14% for 60 days: \$ \_\_\_\_\_
- b. \$ 8,400 at 18% for 75 days: \$ \_\_\_\_\_
- c. \$ 4,000 at 12% for 90 days: \$ \_\_\_\_\_
- d. \$ 9,000 at 12  $\frac{1}{2}$ % for 120 days: \$ \_\_\_\_\_
- e. \$13,000 at 15% for 180 days: \$ \_\_\_\_\_